China, US and the European Banking system. How much struggle to keep on going?

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Worldwide, the banking system is facing more and more difficulties. Many banks have maintained very hard their position in the market; the banking domain has become more and more competitive. Some banks merged in order to continue on living as financial institutions, other have gone bankrupt and closed their financial activity.
This paper seeks to explain the reasons for which the global banking domain weakened so much during the last 5 years. The paper presents also the risks currently facing the global banking industry, as seen by a wide range of bankers, banking regulators and close observers of the banking scene around the world.

Keywords: *liquidity crunch, recession, credit risk, profit before tax, credit expansion*

High dependence on technology is a decisive step that many banks made. Together with this leap grew the complexity of systems and also the ability to manage them.

The criminality is at its upper levels nowadays. The risk of fraud, of data theft and leaks of key information are faced more often than in the past. The desire to be in control and to be competitive on a market that is not as stable as compared to past events. This drive managers in actions that are illegal, untrusting and that harm the competitor's organization.

The human resources and the human capital that the financial entity disposes is weakened by the threat of unemployment that floats in this domain. The fluidity in the market has decreased very much and the motivation is still a

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problem in some areas.

The concern about commodities and about volatile markets has amplified greatly. The slump in metals prices could turn out to be a blessing in disguise for some of the world's largest commodities houses. The trader-cum-producers are vulture buyers that use periods of stress to snap up assets on the cheap. Low commodities prices will hurt them in the short term. First, their profitability of production assets declines; second, weaker prices reduce the profits of trading.

Still, a weak market does provide a hidden opportunity.

Although the emerging economies are broadly in a stronger position than the industrial countries, their concern about the debt problems of the developed world is intense. The risk of a collapse in global demand and of a parallel crisis in the banking markets is currently their greatest worry; none of them, even China, would be insulated from the shocks. Banks in this group are also concerned about the strength of their management, with the growth of political interference a new worry.

Observers of the banking industry are the only group which puts credit risk at the top of the list, believing that banks are acutely vulnerable to the sovereign debt, housing and consumer loan markets. They also share bankers' concerns with funding issues. But they are more worried than bankers about potential losses from derivative products and the mispricing of risk. While they also see political interference as a risk, they do not share bankers' intense concern about excessive regulation. The bankers' chief concerns centre on the operating environment: the state of the global economy, rising debt, particularly on the sovereign front, and the possibility of a new liquidity crunch. The availability of capital and profit prospects are also high on the list. The bankers' response is especially notable for its concern with the negative impact of regulation, and growing political interference in the business. But they also recognize the need for stronger governance and risk management.

The regulators' top three concerns are identical to the bankers', showing a strong alignment of views on the near-term risk outlook. They are also concerned about the operating strength of banks: capital, profitability and back office management. But high on their list is the institutional strength of banks, and their plans for business continuation (crisis recovery). Regulators also show more concern than other groups about the economic outlook for emerging markets.

The top concern in the US is the state of the world economy, in

particular the risk of contagion from the euro zone debt crisis. But the response is notable for the intense focus on the negative impact of regulation and growing political interference in the banking business. Although this is largely a US preoccupation, it is also present in Canada. Credit risk is a generally lower concern, with both economies feeling that they may be past the worst on domestic bad debts.

In what regards the situation in Europe, there things are slightly different. Here, there are major concerns about the sovereign debt crisis that dominates the responses from Europe, both as to its scale and poor handling. Fears of a renewed recession are strong, with bank funding a big issue in several countries, particularly those at the eye of the debt storm. Europeans share North American concerns about the growth of regulation and political interference in banking, though not as intensely. This is the only geographical group which sees the quality of corporate governance as a Top Ten issue. Although not directly affected by the squeeze facing euro zone peripheral sovereigns and banks, central and eastern Europe is affected by its economic ties with the EU and the prevalence of western European banks in its markets.

The fragility of the world economy with the possibility of a return to recession poses the greatest risk to the banking industry in these turbulent times, so any kind of sacrifice seems possible.

The following table shows a rank of 15 European banks that registered the biggest losses.

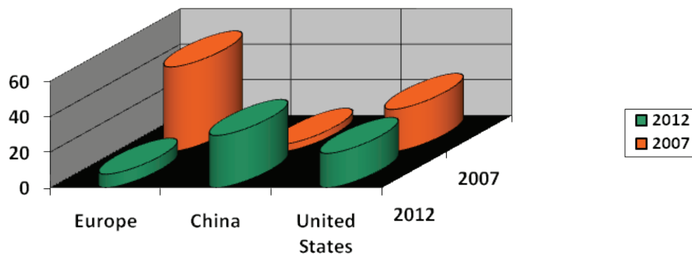
Top 15 European Banks ranked by losses			
Rank	Name of the Bank	Origin	PBT* in $ millions
1.	National Bank of Greece	Greece	-17,364
2.	Dexia	Belgium	-15,127
3.	Intesa Sanpaolo	Italy	-12,428
4.	UniCredit	Italy	-9,998
5.	Piraeus Bank Group	Greece	-9,674
6.	Banco Financiero y de Ahorros Group (Bankia)	Spain	-6,373
7.	Alpha Bank	Greece	-6,123
8.	Banca Monte dei Paschi di Siena	Italy	-6,092
9.	Lloyds Banking Group	UK	-5,476

10.	Cyprus Popular Bank	Cyprus	-5,306
11.	Banco CAM	Spain	-4,518
12.	Allied Irish Banks	Ireland	-4,481
13.	Dexia Bank Belgium	Belgium	-2,776
14.	UBI Banca	Italy	-2,761
15.	CatalunyaCaixa	Spain	-2,590

*Profit before tax= The total profit that is earned by the company and on which the company pays tax.

In the following table there is a comparison of the three most powerful economic areas between their profits during a 5 years period. This period of time includes the year before the financial crisis, in order to see which were the premises of what started.

Comparison between Share of profits (2007 vs. 2012)



Some US community banks managed themselves conservatively and stuck to their knitting while others expanded too quickly on the back of the real-estate boom. While the former are prospering, the problems and failures among the latter are adding up.

A big bank in trouble naturally attracts the headlines. However, what is little known is that the vast majority of US banks that failed in the crisis were small community banks, and these failures are showing no signs of abating. The impact of this on the US economy is profound.

There are many more small (assets of $1bn or less) and medium-sized (assets of $1bn to $10bn) banks – known collectively as community banks – than any other type of bank in the US (6900 small banks and about 300 medium-sized banks out of a total of 7657 institutions). So the overwhelming majority of the 348 banks that have failed since 2007 have been community

banks. Moreover, nearly all of the banks in the Federal Deposit Insurance Corporation's (FDIC) latest list of 884 'problem' banks, about 20% of which are expected to end up failing, are also community banks.

The fate of these banks is considered important because of the crucial niche they have in the US financial industry. The US have an economy where two-thirds of new jobs are created in small businesses. Small businesses like to do business with community banks. Community banks customise products to their needs. The reliance on community banks makes this an essential segment of the financial industry.

Unlike the larger banks in the US, community banks also tend to concentrate on commercial loans averaging $2m or less. Small wonder then that community banks, although they hold only about 20% of the US banking system's assets (total: $13,200bn at December 31), make up more than one-third of the loans to small companies in the US.

Against this background, a common reason among community bank failures is that the banks tended to be in areas that experienced the steepest declines in property values when the real-estate bubble burst in 2007, as well as the biggest job losses from the recession, say regulators, bankers and analysts. In these areas – comprising 'sun belt' states, such as California in the west and Florida and Georgia in the south east; and 'rust belt' states, such as Ohio and Illinois in the upper Midwest – community banks have overextended themselves in real-estate lending, in particular in land acquisition, construction and development (ACD), and commercial real estate (CRE) loans.

Those concentrations have been a primary reason for the failure of many small and medium-sized institutions, according to both the FDIC's Mr Brown and Chris Cole, a senior vice-president at the Independent Community Bankers of America, a lobby and advisory group that links 5000 community banks.

The US's south east has been the most affected area. Florida and Georgia accounted for nearly one-third of all the 157 bank failures in the country in 2010. Analysts expect that in 2011 Florida and Georgia will again be the areas with the most problem banks, for example, those with enforcement actions from regulators and bank failures.

A recent example of a failing small bank is Citizens Bank of Effingham, Georgia (with assets of $214m), which in its last FDIC filing on December 31, 2010, before it went into receivership, had a capital adequacy ratio of just 1.02%, too little to continue operating safely, and 59% of its total assets were in real

estate.

Heritage Bank of the South, based in Albany, Georgia (assets: $950m), acquired Citizens Bank in an FDIC-directed auction in February. The reasons for the bank's failure are pretty much the same story that was seen in many places in the south east. A number of banks in so-called 'hot' markets saw a tremendous amount of growth and expansion, which created a lot of real-estate building, new subdivisions, new homes and a high concentration of ACD and CRE lending. Georgia and Florida had severe problems with that. And Atlanta in Georgia, really drove a lot of that sort of growth.

Inadequate risk management of a heavy concentration in real-estate lending was also the reason for the failure in February of Valley Community Bank (with assets of $124m) based in the St Charles suburb of Chicago, where there was considerable real-estate development before the property crash. Property prices are still falling, and this institution, which the FDIC first listed as a problem bank in May 2009, had a risk-based capital ratio of -0.88% and a 19% non-performing loan ratio, according to its last FDIC filing at the end of last year.

While too little capital has led to the failure of some community banks, others with a lot of liquidity and capital have found opportunities in the crisis. For example, Heritage Bank of the South had a capital adequacy ratio of 26.4% as of December 31, 2010, and is well placed to expand through acquisitions.

Meanwhile competition from larger regional and national banks for commercial and industrial lending relationships, residential mortgage origination and the most profitable segments of consumer lending (credit cards and auto credits) was putting pressure on community banks even before the crisis and contributed to their increased focus on commercial real estate, according to regulators.

The upshot is that community banks had been branching out by making loans in property development and construction, and commercial real estate, which tend to be long-term and involve large sums of money. Because of this increased competition, they have also increasingly wanted, when making loans to small businesses, to take real estate as collateral with the aim, in theory, of protecting themselves.

This has tended to make the sector vulnerable to trends in the real-estate market. And that's what has hit them in this cycle.

Indeed, banks with assets of $10bn or less in the US not only accounted for half of all the system's commercial real-estate loans at the end of 2009.

Seventy-five per cent of these banks' total loans were also secured by real estate at June 2010, district federal reserve bank reports claim.

The real-estate problems of community banks are also far from over. From 2010 to 2012, for instance, tens of billions of dollars in commercial mortgages come up for renewal by banks and in many areas these properties (offices, warehouses, shopping centres, hotels, apartment blocks) are worth less than they were when the loans were made, bringing new challenges to already stressed smaller banks.

In contrast with their failed peers, community banks that survived the crisis have tended to be based in areas where property prices and local economies have held up, such as in Virginia and Maryland in the mid-Atlantic states, and New England and New York in the north east.

This fact is backed up by Burke & Herbert Bank (assets: $2.2bn), when it comes to explain about the city of Alexandria in northern Virginia, where this bank has been operating since 1852. This is a great area, just outside of Washington, DC, because the government continues working regardless of good and bad economies. There are not just government workers, but all the subsidiary contractors and industries that support the government and service businesses, such as restaurants, doctors, lawyers and engineers. Some say the area is recession-proof. That’s not true. But it is resilient.

Similar to California’s Oak Valley Community Bank, Burke & Herbert Bank is also doing better than its peers. It had a 10.16% core capital ratio, a lower-than-the-US-average 0.66% non-performing loan rate and a higher-than-the-US-average 1.59% return on assets on December 31 last year. At the same time, Oak Valley Community Bank had a capital-asset ratio of 14%, a non-performing loan rate of 2.2% and a return on assets of 0.89%.

Successful community banks also maintained diverse revenue streams. Consider Oak Valley Community Bank’s list of personal and business customers, which reads like the proverbial butcher, baker and candle-stick maker. It includes a hauler and grower of walnuts, a medical supply company, a concrete contractor, a cold storage facility, a chiropractor, a hotel, a tree nursery, a church, an ice cream and pizza company and a garbage disposal company. Another contrast is that before the crisis, community banks that failed were often the fastest growing, while those that are thriving now were treading a more steady path.

Before the recession the Burke & Herbert wasn’t the star bank locally. There were banks making much higher returns. But this bank didn’t want to

take risks. The bank didn't want to invest large amounts of its capital in mainly home construction. So one reason it was successful is because when the crisis hit, the bank didn't have to plough a lot of its money into loan loss reserves, which other banks did.

Additionally, failed banks often gained market share at the expense of competitors, not only by over-concentrating loans in a particular segment, but also by relaxing standards.

For instance, according to the Federal Reserve Bank of Atlanta, 93% of construction and development loans made by community banks in the south east in 2009 were extended to builders to construct homes that were not pre-sold, making these loans highly speculative. And this was done when the banks' own internal policies limited such loans to 60% of their residential construction loan portfolio, the federal district bank noted.

In contrast, Heritage Bank of the South, during the 2002-06 property boom never changed its underwriting to reflect some of the aggressive underwriting standards that were adopted by other banks.

The key factor, the reason this bank survived the crisis, is that it was stuck to some basic tenets of credit.

Successful community banks also tend to maintain relationships with local customers and businesses, and stick to the markets where their name and reputations are known.

For example, First Community Bank, New Mexico's biggest community bank ($2.3bn in assets and 38 branches), was successful when it stayed in its home state, but when it embarked on a buying spree, expanding into Colorado and Utah in 2002 and Arizona in 2006, it met its demise.

While it made some mistakes in New Mexico, the expansion into markets that it was not familiar with, and a heavy shift towards land loans and real-estate development loans in those markets, is what ended up being the final blow for the organisation financially.

A further characteristic of successful community banks is that they control costs, such as the cost of deposits. There are methods to be followed so it's not just looking up the street and some other bank is paying a higher rate on deposits so the bank raises all its rates. The banks do it more selectively.

There were community banks which failed that were opening loan production offices in different parts of the country, and to fund those loans they increased their dependence on wholesale funds and were taking brokered deposits (which are more costly than core deposits). That certainly has been a

practice that has caused a number of banks to have difficulties and a number of them have failed.

Summing up small banks' failures and successes, remains to be remarked with modesty and also with a degree of irony that some banks look smarter than they really are, but this is because everyone else did such dumb things.

Top 15 US Banks ranked by losses				
Rank	Name of the Bank	Origin	Date of closure	Estimated DIF in $ millions
1.	Second Federal Savings and Loan Association of Chicago	Illinois	July 2012	76.9
2.	Jasper Banking Company	Georgia	July 2012	58.1
3.	Waccamaw Bank	North Carolina	June 2012	51.1
4.	Putnam State Bank	Florida	June 2012	37.4
5.	First Cherokee State Bank	Georgia	July 2012	36.9
6.	Security Exchange Bank	Georgia	June 2012	34.3
7.	Farmers Bank of Lynchburg	Tennessee	June 2012	28.3
8.	Georgia Trust Bank	Georgia	July 2012	20.9
9.	Waukegan Savings Bank	Illinois	March 2012	19.8
10.	Carolina Federal Savings Bank	South Carolina	June 2012	15.2
11.	Royal Palm Bank	Florida	July 2012	13.5
12.	Farmers and Traders Stare Bank	Illinois	June 2012	8.9
13.	First Capital Bank	Oklahoma	June 2012	5.6
14.	Heartland Bank	Kansas	July 2012	3.1

The state of China's banks is a divisive topic – are they on the brink of collapse or part of a stable, state-controlled system? The country's financial institutions are reporting high profits and deposits, but with unquantified levels of bad debt, concerns over asset quality and overexposure to a weakening property market, questions are being asked about the long-term health of the sector.

China's banks are growing rapidly, climbing up the global rankings, and could one day be the world leaders in the banking industry. Or they are institutions riddled with bad debt, propped up by the state, that could one day collapse in the Chinese equivalent of the subprime crisis. Views on China's banking sector can lie anywhere on the spectrum between these two extremes, but whatever the view of China's banks, their problems cannot be ignored because of the sheer size of these institutions.

Among the areas of concern are the rise of shadow banking and off-balance-sheet activity, the level of non-performing loans (NPLs), and overexposure to local government debt and the property sector. While many agree on the problems, the degree to which they pose systemic risk and their potential to cause a banking crisis is hotly debated. Opinions vary on the true state of China's banks and what lies inside them. They can be viewed as healthy and profitable with ample reserves, or they can be seen as part of a system where the level of risk and bad debt has been hidden.

Strengths and weaknesses of China's banks

Strengths:

- Banks are reporting profits and healthy margins.
- There is a high level of deposits.
- The household sector is not highly leveraged.
- There is a high level of provisions.
- The closed system limits risk of global contagion.
- The state has control to directly intervene and manage problems.

Weaknesses:

- The rise of shadow banking and off-balance sheet investments.
- Exposure to local government debt.
- Exposure to the slowdown in the property market.
- NPL figures are not accurate as loans have been rolled over and restructured.
- Closed financial system means that problems could be hidden.

China is the one place in the world to be sure that no banking crisis will exist in the near future. The crises inside China's banking domain is dismissed, these kind of speculation only exists as rumours. Another view is that the problems in the Chinese banking sector have already reached crisis proportions. Some specialists say that maybe China is in a banking crisis and not even know it.

China's banks, unlike their US or European counterparts, are part of a closed system where they are effectively viewed as levers by which the government can control the economy. On the one hand, this gives the state direct control to manage any problems, but also it means that problems could be manipulated and disguised so that their true scale is not obvious.

The closed nature of the system means that there is limited scope for global contagion, which affects what a crisis would look like. After the bubble burst in Japan and the banks sat for many years on bad loans and threw good money after bad, the Japanese bankers pretended the problems were not there. It was not a crisis but Japan did have zombie banks.

The experts add that while the problems remain inside a closed system, they can be contained. However, in the past year the rise of off-balance-sheet activity has been a cause for serious concern and now the risk has metastasised and may not be as easy to contain as it was before.

With a ceiling on deposit rates, Chinese investors have been looking for better returns. Deposits have been invested into off-balance-sheet vehicles, and because the funds are moving away from the regulated sector there is the potential for the funds to be mis-invested or mis-sold.

The banks have introduced would-be depositors to would-be lenders through trust companies, which make a range of investments, and the bank charges a fee for this service. They packaged a lot of assets that the banks say are good, but they might not be. It is not clear where the risk lies, whether the risk is held by the bank or by the investor. Everyone assumes that everyone else holds the risk. You have repackaged the risk in the banking system and sold it to retail investors.

Fitch Ratings notes that the advantages of such wealth management products (WMPs) include the lowering of banks' reserve ratio requirements (RRR). For banks, the benefits associated with WMP issuance stem from the ability to shift the assets and liabilities underlying the WMPs on and off balance sheet, which they typically do through strategically setting product start and end dates. This enables banks to lower deposit balances between periods to avoid high reserve requirements, while giving them the flexibility to bring the deposits bank on balance sheet at period-end to pad loan/deposit ratios.

The rapid growth of these products is putting a strain on the banks when it comes to managing the payouts. Fitch says that liquidity has tightened resulting in a growing reliance on interbank borrowing to repay product investors: There has been an intensifying month-end scramble for cash to

cover product payouts and the additional RRR allocation.

Whether such products pose a systemic risk is debatable. All depends on the quality of the lending. If they are all good loans, then there is not a problem.

Concerns about asset quality extend to other areas of the banks' business. Research by Credit Suisse states that a view on China's banks is completely a call on the potential impairment. The research cites real estate, manufacturing, local government and small and medium enterprises-sized as the main sources of credit risk, both on and off balance sheet. In terms of the level of NPLs at Chinese banks, Credit Suisse forecasts a NPL ratio of 8% to 12%, much higher than the levels that are being officially reported.

In particular it is expected the increase in NPLs to be more pronounced inside the real-estate and exports-related sectors. In addition, it would be likely to see more impaired loans among local government financing vehicles, although most of these loans may still be considered as performing after restructuring. For the banks, other challenges include further enhancing deposit bases, given the competition from non-bank financial institutions, and managing capital for growth.

Despite these concerns, the experts do not believe that there will be a banking crisis in China. The level of bad debt is now the "hangover after the party" following the rapid credit expansion that China undertook as a response to the global financial crisis in 2008. Because of the credit expansion, a lot of the banks were ordered to make loans which they did not think were creditworthy. Lending to local governments has been a concern to many observers. Since local governments are unable to borrow directly from banks, banks have been lending to local government financing vehicles (LGFV), which were set up to get around these rules. These loans were implicitly given guarantees by the government.

Standard Chartered research estimates that with about 10,000 LGFVs, local government sponsors are sitting on approximately Rmb10000bn to Rmb14000bn ($1500bn to $2100bn) worth of loans, of which Standard Chartered estimates Rmb2000bn to Rmb3000bn – the equivalent of 6% of China's gross domestic product (GDP) – are in trouble. If it is to go further and to assume that a large portion, if not the majority, of these loans will not be repaid by the projects currently using the funds, says the research, which foresees that the problem will need central government intervention. In February 2012, the Financial Times Magazine reported that the banks have been instructed to

roll-over the loans, which buys the banks some time and postpones having to deal with the impact of the bad debt.

It is unrealistic to assume that Chinese banks don't have problems, because these issues exist – that is very clear. They have problems with their exposure to local government debt and exposure to the property sector, but the risk of a banking crisis is very small this year and next year.

What is more to be concerned of it is about the banks' exposure to the property sector than the local government debt problem. Property prices are going through a serious adjustment and a sustained collapse would hit the banking sector hard. According to research by Standard Chartered, the property market is weak and the average land price has corrected 35% from the peak in late 2010. Developers are feeling the pinch, but relatively few are on the verge of collapse.

The government can control these problems and there will not be a systemic impact on the economy, due to the fact that real estate is not leveraged on the household side. NPL levels within Chinese banks are still a concern for analysts, however. The experts from Standard & Poor's believe that the credit losses could be significantly higher in the next few years. The banking system has to focus more on absorbing the potential losses rather than providing new credit. That could become a big headache for the Chinese economy.

A scenario where the Chinese banking sector is heavily hit is relatively remote to narrow. The reasons for this are the structural strengths of China's banking system. The liquidity profile of the banking system remains quite strong. It is to be pointed out that loans of Chinese banks are fully funded by customer deposits and most banks in China do not rely on wholesale funding. Moreover, the profit capacity of the sector and the net interest spread is protected by the regulator as a strength.

As a conclusion, the banks are still worthy of investment. If one looks at the banks, one actually likes them: they are very profitable, they have strong underlying earnings, good margins, and are regulated. This can be seen as a potential for organic growth – retail lending is still underdeveloped, because the exposure to real estate is something to look at, and there are worries about the exposure to LGFVs and growing NPLs, but these problems are manageable. The provisioning of the Chinese banks could cover a fair amount of NPLs. It is estimated that the maximum provisions out of operating profits are sufficient to write off 350 basis points of NPLs every year. Over three years that means that cumulative NPLs could be absorbed as high as 10%. The key question

is whether the potential spike in NPLs for the banking sector could be even higher than 10%.

There are other strengths in the system, and many argue that the Chinese authorities have the capacity to manage and control the problems. Moody's has an AA3 rating on China, which is supported by the country's high degree of economic resiliency and very high level of financial robustness. Robust growth makes problems in China, including in its banking system, manageable. Ample fiscal headroom can likely accommodate possible contingent liabilities which may arise from the exceptional fiscal and financial stimulus implemented during 2009 and 2010.

The Chinese authorities have so far been able to manage the problems in the banking sector, and in many cases allowed banks to either roll over the loans – which means they do not make it to the official NPL figures – or restructured them. This has given the banking sector some breathing room, but sometime in the future a day of reckoning could come.

Fitch's research stated that in theory, such practices can continue indefinitely as long as bank shareholders are willing and able to provide this forbearance, and as long as other parts of the economy are strong enough to offset the drag on growth. However, the concern in China today is that the banking sector's forbearance burden is rising at a time when funding and liquidity are dwindling and financing needs remain high.

For the first time, a large number of Chinese banks are beginning to face cash pressures, and fewer resources are available today than in the past to carry the economy through an extended period of forbearance. It is because of this cash constraint that the forthcoming wave of asset quality issues has the potential to become uglier and more destabilising than in previous episodes of loan portfolio deterioration.

This happens also because bad debt is being rolled over, new credit is not available for the funding of new loans.

Whether there will be a hard landing – which it is defined as a slowdown to an average of 5% growth in GDP over four consecutive quarters – remains to be seen. In March 2012, China's prime minister revised the country's growth target downwards to 7.5%. If there is a slowdown in the economy, it could severely impact the banking sector and could trigger even more NPLs.

This would be a case of China's economy having an impact on the banking sector, but some observers believe that the problem will occur the other way round. They argue that there are enough concerns with the banks –

with off-balance-sheet activity, local government debt and the property sector – to cause a crisis in the banking sector first. Whether this will be the case remains to be seen, but what is certain is that the state of China's banks will continue to be hotly debated.

Conclusions

Five years on from what is considered the start of the credit crunch – dubbed the day the world changed by the former boss of Northern Rock – the public are more disillusioned with the banking sector than ever. More people are managing to do without banks.

That's the conclusion of a recent study by the FDIC, which found that 821,000 households opted out of the banking system from 2009 to 2011, and that the ranks of the unbanked has soared. As of now, about 17 million adults do not have a checking or savings account. About 51 million adults have a bank account, but use pawnshops, payday lenders or rent-to-own services, the FDIC said. This group of under banked people has grown to 20.1 percent of households from 18.2 percent.

Obviously, banks are revenue-challenged at the moment, and most have no choice but to scale back in a variety of areas. Small accounts are rarely profitable, especially when you cannot easily charge fees. So the growing ranks of the under banked is in some ways a logical outcome of the current industry malaise. Banks can't afford to subsidize tiny accounts. They pretty much have to emphasize service in areas where there is money to be made.

It might be tempting to think that consumers are better off without banks, but that's a foolish conclusion. While banks have been pilloried for all manner of ethical lapses and hard-to-justify fees, the reality is that they tend to be infinitely preferable to some of the shady firms that people in lower-income areas often have to turn to financial services. Some charge exorbitant rates and the fees are even higher.

The only real answer is a return to prosperity and this implies to have the sort of economy that generates enough income and demand for services such that banks and others respond. That's not going to happen soon, so perhaps other non-profit institutions need to step in with innovative services.

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